Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Income Fund

Quarterly update December 2022

Twenty Twenty-Two was an extraordinary year, but then again, isn't every year extraordinary in its own way? Our fund delivered a positive return in 2022 – just. We also grew our dividend by 10%, roughly in line with volatile CPI, which meant that we preserved the purchasing power of the income we paid out. Importantly, investors, very slowly, are beginning to understand the attractions of the UK market, a market which outperformed the FTSE World Index by a country mile last year.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone Income Fund	11.3%	8.2%	0.1%	7.9%	17.0%
IA UK Equity Income Sector	10.8%	4.1%	-1.7%	3.9%	11.6%
FTSE All-Share Index	8.9%	5.1%	0.3%	7.1%	15.5%

	31 Dec 21-31 Dec 22	31 Dec 20-31 Dec 21	31 Dec 19-31 Dec 20	31 Dec 18-31 Dec 19	31 Dec 17-31 Dec 18
Rathbone Income Fund	0.1%	20.6%	-10.6%	18.6%	-8.6%
IA UK Equity Income Sector	-1.7%	18.4%	-10.7%	20.1%	-10.5%
FTSE All-Share Index	0.3%	18.3%	-9.8%	19.2%	-9.5%

Source: FE Analytics; data to 31 December, I-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

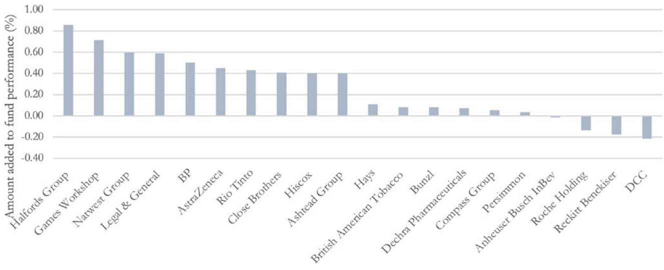
The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

We had a very strong end to the year, gaining 11.3% in the fourth quarter, putting us ahead of the UK Equity Income sector average (+10.8%) and the benchmark FTSE All-Share Index (+8.9%). Over the 12-month period, our fund just inched into positive territory, gaining 0.1%, hanging on to the coat-tails of the main index, which was up 0.3%. The UK Equity Income sector averaged a loss of 1.7%

Three-month stock review

Almost every holding in the fund made positive returns, but the outstanding contributions originated from two of the laggards from the first half of the year: automotive service provider and bike retailer **Halfords** and war gaming manufacturer **Games Workshop**.

Q4 contributions



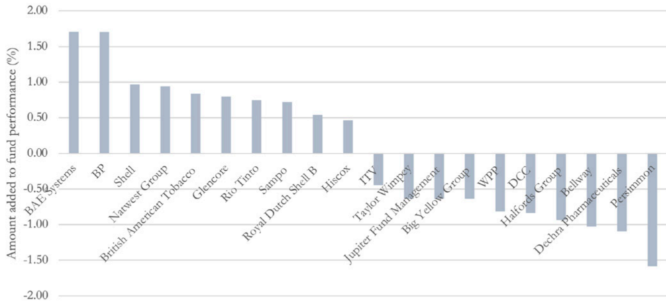
Source: StatPro; Rathbones

We have owned Halfords for a very long time — perhaps too long considering the historically dramatic fluctuations in both share price and operational performance. This is a 'marmite' stock that attracts as much criticism as it does support. However, we firmly believe in the strategy established by CEO Graham Stapleton, just now approaching the end of his fifth year at the helm. Think about what the last five years have brought about: Brexit, supply chain disruptions, massive sterling weakness, COVID-19 and the war in Ukraine. Through all of this, Halfords has made the necessary evolution from a one-off sale retailer to a service-oriented business, shifting from the discretionary 'nice to have' category to more needs-based spending. In practical terms, it's the difference between selling a car battery or a new bike and waving its owner goodbye, and signing the customer up for routine MOTs, services, and other maintenance and safety checks for years to come. This was achieved through a steady progression of empirically evaluated strategic initiatives, as well as considered acquisitions. Share price volatility, reflecting investor angst in regards to the local and global economic environment, has rarely reflected this long-term vision, but we are pleased to report a very strong recovery in the shares in the final quarter of the year.

Games Workshop is another retailer with a long-term philosophy somewhat at odds with the more short-term attention span of the stock market. In the words of its chairman, they advocate "long-term success, not short-term gains — 'forever' is an important word to us. We know that to achieve our ambition to be around forever, running the company that we love, we have to have a responsible and principled approach in our dealings with all of our stakeholders." Having fallen behind at the start of the year as trading disappointed, the shares have recovered very well into the year-end, the mood supported by a deal with **Amazon** that will allow them to produce a new TV series based upon its Warhammer 40,000 war game universe, an old and rich mine that has been virtually untouched for decades. It is difficult to evaluate the potential worth of this partnership, but we had argued that it was under-appreciated by the market. Importantly, this deal could have legs — think about the success Marvel had in bringing its superhero catalogue to the screens.

Otherwise, large-cap names dominate the list of positive movers, with financials (**NatWest**, **Legal & General**, **Close Bros**, **Hiscox**) to the fore, alongside other giants of the FTSE 100 — oil major **BP**, pharmaceuticals business **AstraZeneca** and miner **Rio Tinto**. As markets recovered, very few exposures were drags on performance, and of those that were, we have sold brewer **AB InBev**.

12-month stock review



Source: StatPro; Rathbones

While the final quarter was a positive denouement to a challenging year, the 12-month numbers reveal the real stock story of 2022: very large disparities between the winners and the losers.

The FTSE 100 trounced other major developed markets, benefitting from two primary factors, its value and its cyclicality, powerful characteristics that remain in place as we embark upon a new year. In 2022, if you didn't own the miners, the oils and the banks, you were toast. More than that, the 10 largest stocks in the FTSE All-Share rose an average of 30%, making it a very tough index to beat. We're pleased that we came within a whisper of achieving this feat, and by the fact that we are ahead of the IA UK Equity Income sector for the last four years out of five.

The divergence in individual stock performance was startling to behold, with global defence contractor **BAE Systems** up over 60% in total return terms over the year, and housebuilder **Persimmon** halving in value. Not owning energy stocks would also have been painful, with **Shell** and BP up very roughly 50%. Although investors were not predicting the war in Ukraine and the ensuing spike in energy prices, the breakdown in supply chains, screeching turns made by sovereign states towards matters of energy and defence security, and dramatic spike in inflation, the point is these stocks were cheap at the start of the year. Conversely, high valuations in other risk assets, with hindsight, smacked of complacency; if there's one thing we should have learnt over the last 15 years, it's that the wheels do sometimes come off.

So as inferred above, while we did well owning miners, oils and banks, we lost out owning housebuilders, global businesses like **DCC** and **WPP** which suffered as fears of a global recession took hold, and growthier names like **Dechra Pharmaceuticals** where valuation and the fear of earnings downgrades trumped some excellent deals made during the year. Despite a strong final quarter as explained above, Halfords still failed to make up the ground lost at the start of the year.

Outlook

As we embark upon a new year, the mood is generally sombre. The UK is riven by strike action, broken politics, a severe cost of living crisis, the real possibility of a housing crash, and a National Health Service that looks to be failing. It is not surprising that one senior industry professional opined to us last year that overseas investors still have next to no interest in investing in the UK – it is broken. Things are about as difficult as they can be, and we are about to enter one of the most widely flagged recessions of all time.

Yes, we know all of that, and that is the point

Things were bad this time last year, and we still had the Ukrainian war with which to contend. And they were pretty poor two years ago. And yet, you'd have missed out if you hadn't invested in the UK market, at least in the income-providing bit of it – the dull old-economy dinosaurs that are so easily written off when easy money can be made elsewhere. Investors have certainly conflated the UK economy with the UK market, and we have seen that in our own portfolio with domestic names struggling for much of 2022, while deep-value mega cyclicals have soared. Nevertheless, the UK market remains cheap and unloved, and that's where the opportunity lies. Is a global recession yet priced into the US market, despite the underperformance of the S&P 500 last year? Is it complacent to argue that the central banks will buckle, become less hawkish, and allow risk assets to fly once more? If you're not sure, you should look to the UK as a possible insurance policy, especially with the attractive dividend support that it can provide in uncertain times.

The UK market does march to a different beat – in our marketing presentation we highlight graphs produced by the American investment bank Citi, in which they detail UK corporate earnings revisions versus those of US businesses. Over the last 12 months, UK plc has been just as likely to be upgraded than not, while American companies, so primed to beat analyst expectations, have more consistently disappointed. At worst, this reflects low expectations for the UK; at best, it suggests an underappreciated resilience.

We don't know what 2023 will bring. It has started well, as the mild winter has dampened demand for gas around Europe, lowering wholesale prices, and raising hopes of a less-inflationary environment. UK newspaper headlines are worrying, but UK retail parks actually experienced the biggest rise in post-Christmas footfall, with more than 60% more shoppers venturing out on 27 December versus Boxing Day. We await trading statements from our retail businesses with bated breath, recognising that sales are still below pre-COVID levels, but optimistic that the news may positively surprise. But this noise should not distract us from our long-term mission.

The paradox of writing a quarterly report is that our process and our objectives are established upon a long-term ambition, while the quarter's news is ephemeral. This is why we have emphasised the strategic integrity and worth of our winners this quarter. If your investment aims are capital preservation and income growth over many years to come, we need to invest in businesses that are strategically driven to fulfil those aims, not motivated by the next quarter's trading statement. Often the market disagrees, so we must ride out that volatility to maintain focus on the ultimate prize.

Recent trading: In December, we bought a decent position in miner **BHP**, having sold all our **Glencore** in November. We also added to Games Workshop on the announcement of the tie-up with Amazon.

Companies seen in December: WPP.

Carl Stick
Fund Manager

Alan Dobbie
Fund Manager

Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

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